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CAPITAL AND CAPITAL STOCK.

There are certainly few legal expressions more familiar than "capital," "stock" and "capital stock." And yet when one examines the statutes and decisions in which they are employed, he finds the most extraordinary confusion and vagueness of thought. Possibly it would be more fair to the courts to say that legislatures have been at sea in the use of the terms, and judges, in endeavoring to clarify the situation, have only increased the tangle. It certainly ought not to be unprofitable, therefore, to inquire whether these several misconceptions may not be described with precision and future disorder lessened.

Both "stock" and "capital" seem to have been originally economic rather than legal in their significance. As adopted by Adam Smith and Malthus, the definition of the former was accumulated values from past labor, while the latter was the portion of such values employed in the production of more wealth.¹

With the development of corporations both of these words, while retaining the economic, acquired gradually distinct and technical meanings. Stock thus came to mean the undivided interest which a shareholder had in the net assets of a company, while capital became the permanent funds with which the business of the corporation was conducted and which in general arose from the original sales of its "stock."²

The further division of "stock" corporations, however, into "monied" and "business," that is, banking and mercantile, produced a still narrower specialization of the word "capital." It is evident

1. Lalor's Cycl. Pol. Science, Article "Capital."

2. See Bouvier Law Dictionary, Rawle's Revision, Article "Stock."

that whatever funds were originally subscribed might be greatly augmented in value by judicious management and investment, or reduced to the vanishing point by misfortune or bad judgment. But by reason of the peculiar functions of banks, subscribers to the "stock" were obliged to pay the corporations the nominal amount of such subscriptions in cash. The aggregate fund thus received became a fixed, permanent "entity" to be invested apart from other resources, not increasing in its nominal value and not permitted to fall below without imposing an obligation upon the stockholders to make such deficiency good.³

This is the present "capital" in the technical sense of the word. Now, mercantile corporations, we believe, have never been obliged to maintain a rigid and carefully guarded fund. At one time they were obliged to commence business with the amount specified in their certificates of incorporation subscribed in cash. But this rule has been relaxed, and stock may now be issued originally for property or labor as well as cash, and in the absence of fraud no question as to the value of the *quid pro quo* may be raised.⁴ Nor from that time to the dissolution of the corporation is there any fixed amount to be preserved in cash or in property instantly convertible into cash. In brief, business corporations are supposed to have "capital" but are not obliged to maintain "a capital." It is the failure to observe this simple distinction that seems to be one of the principal grounds of confusion, and when the words were blended in the phrase "capital stock" without any precise explanation of what was intended thereby, the perplexity was very largely increased.

In the National Bank Acts, "capital stock" appears to be employed in two distinct senses without any suggestion in the text that this is so. Thus in section 5140 of the Revised Statutes, which begins "At least fifty per centum of the capital stock of every association shall be paid in before it shall be authorized to commence business" it is clearly used as identical with "capital."⁵ Section 5143 begins: "Any association formed under this title may, by the vote of the shareholders owning two-thirds of the capital stock, reduce its capital to any sum," etc., where the phrase refers to the shares owned by the stockholders.⁶ While in order to be strictly impartial, in section 5205 it is used in both senses within a few lines. Thus: "Every association . . . whose capital stock shall have

3. U. S. Revised Statutes, sections 5140 and 5205.

4. Cook on Corporations, fifth edition, section 18.

5. See Federal Statutes Annotated (1905), Volume V, page 101.

6. See Federal Statutes Annotated (1905), Volume V, page 103.

become impaired by losses or otherwise shall . . . pay the deficiency . . . by assessment upon the shareholders *pro rata* for the amount of capital stock held by each.”⁷

The United States Supreme Court in the Delaware R. R. Tax case,⁸ attempted to explain matters. In this case the State of Delaware had passed an act taxing railroad and canal companies “one-fourth of one per cent upon the actual cash value of every share of its capital stock” and in the course of an opinion upholding the tax Justice Field observed: “The share of a stockholder is, in one aspect, something different from the capital stock of the company; the latter only is the property of the corporation; the former is the individual interest of the stockholder.” The learned justice thus suggested that “capital stock” is a fund of the corporation in order to pave the way for a declaration that the burden was imposed upon the corporation and not upon the stockholders. It seems, however, that this was quite unnecessary as the law distinctly stated the tax to be upon the “*cash value*” of the shares and not upon the “capital stock.” In other words, the eminently just figure of the amount that would have been distributable upon the stock if the corporation had then gone into liquidation, was made the measure of the assessment, but the obligation was imposed upon the company itself. The decision was doubtless correct but this remark appears to have been erroneous. However, in another case reported in the same volume,⁹ Justice Field went still further and interpreted a statute of Missouri which read: “The stock of said company shall be exempt from all state and county taxes” as follows: “Some attempt was made from the use of the term *stock* . . . to establish the position that the exemption extended only to the separate shares of the individual stockholders. But . . . the terms “stock of the company” imported the capital stock of such company, the subscribed fund which the company held, as distinguished from the separate interests of the individual stockholders.” Here the learned justice took the liberty of interpreting “stock” of a railway company as denoting the same as “capital stock” in his opinion in the Delaware R. R. Tax case. If, however, words mean anything, it would seem that a stockholder is one who holds stock and that consequently “stock” is what is possessed by the shareholders. It may be that the intention of the legislature was correctly interpreted but it certainly would have been more accurate if Justice Field had said plainly that

7. See Federal Statutes Annotated (1905), Volume V, page 143.

8. 18 Wall. 206.

9. *Trask v. McGuire*, 18 Wall. 402.

they had employed in the statute a word they did not mean, instead of stretching "stock" in so merciless a fashion.

It will be observed that in neither of these cases did the court suggest that they were deciding that the same words might be employed to mean totally different things at different times. But in a later Federal case¹⁰ this explanation was given: "The *capital stock*¹¹ of a corporation in its merely nominal sense, is the sum specified or authorized in its charter and thereby usually divided into aliquot . . . shares. . . . In its substantial sense, [it] is the fund of money or other property actually or potentially in its possession, derived or to be derived by it from a sale of its shares. This fund includes not only money or other property received by the corporation for shares of stock, but all balances of purchase money or installments due the corporation for shares sold by it, and all unpaid subscriptions for shares. The fund may through accident, shrinkage in values, or business misfortune be impaired; but subject to such contingencies, it is intended to and should be equal to the par value of the nominal *capital stock*¹² which it represents."

Here the court admitted that there are at least a substantial and a nominal meaning to "capital stock" which have nothing in common. He succeeded, however, in employing it in three senses: (a) the capitalization named in the charter, (b) proceeds of sale of stock, and (c) (at the end of the quotation) the stock in the hands of shareholders.

In a New York case¹³ where a monied corporation taxed upon the "actual value of its capital stock" resisted an assessment based upon the market value of the shares, asserting that by the phrase was meant its capital, which was invested in United States bonds and so not taxable,¹⁴ the court announced unequivocally that there are two entirely different meanings to "capital stock" and that they have nothing whatever to do with one another. No rule was suggested by which one might know which meaning was intended in any particular case, Judge Finch saying merely: "That of the company is simply its capital, existing in money or property, or both; while that of the shareholders is representative not merely of that existing and tangible capital, but also of surplus, of dividend earning power, of franchise and the good will of an established and prosper-

10. *Hamor v. Taylor Rice Engineering Co.*, 84 Fed. Rep. 392.

11. Italics the writer's.

12. Italics the writer's.

13. *People ex rel. Union Trust Co. v. Coleman*, 126 N. Y. 433.

14. *Bank Tax Case*, 2 Wall. 208.

ous business. . . . There are reasons in abundance for the conclusion that by the phrase "capital stock" the statute means not the share stock, but the capital owned by the corporation; the fund required to be paid in and kept intact as the basis of the business enterprise and the chief factor in its safety. One ample reason is derived from the fact that the tax is assessed against the corporation and upon its property and not upon the shareholders and so upon their property."

The court apparently intended (as we said) that there are these two well defined and generally accepted meanings. But nothing could be clearer to one reading statutes or opinions than that scarcely any of the users were aware that they were employing an equivocation like, for example, the word "present" (meaning "now" or "gift") for there is not the slightest attempt to indicate which of the two is intended.

Bouvier¹⁵ in his definition of "capital stock" welds the two conceptions together and produces the extraordinary description that it is the sum divided into shares which is raised by mutual subscription. But the money in the hands of the corporation is not divided into "shares" nor are the shares of stock in the hands of the stockholders "sums of money."

It would be a very simple matter to prevent this uncertainty. As a matter of fact "stock" and "capital stock" are now synonymous, referring exclusively to the shares held by the stockholders, the only possible distinction being that the former is usually used distributively (as "the stock owned by Jones") and the latter collectively to represent the sum total of shares outstanding. The shifting of the conception from asset to liability is illustrated by an interesting change in the phraseology of stock certificates. In a Massachusetts case of fifty years ago¹⁶ a certificate in dispute read as representing so many "shares *in* the capital stock," whereas to-day the well-nigh universal rule is to have the wording "so many shares *of* the capital stock."¹⁷ Moreover, if, as the Supreme Court and state courts maintain, the phrase denotes the possessions of the corporation, why should it not be used as a description in corporate mortgages? Yet who can doubt that if a company undertook to

15. Law Dictionary, Rawle's Revision.

16. *Fisher v. Essex Bank*, 71 Mass. at page 374.

17. See for example Forms in White on Corporations, fifth edition, pages 929, and 932. *Contra*, page 930. Also Dill on General Corporation Act of New Jersey. In *Hall & Farley Trustees v. Henderson* (126 Ala. page 481), "capital stock" is employed correctly as meaning the stock in the hands of the shareholders.

mortgage "capital stock" everyone would suppose that the "treasury stock" was intended, that is, the share stock not yet marketed? And if a company is taxed "upon the actual value of its capital stock" is it not perfectly evident as was said above, that the tax is one upon the *company*, establishing very justly its taxable wealth as equal to the value of its net assets or, in other words, the amount that would be distributable among the stockholders in case the corporation were liquidated at that time?

"Capital" should be confined strictly to the permanent fund of a monied corporation. As was noted above, business corporations have not "a capital" that they are obliged to maintain. Nothing, unfortunately, is more common than the existence of a company without cash or a dollar's worth of property of any kind and no possibility of calling upon the stockholders for assessments. They have "capitalization" (that is, the nominal or par value of the stock) "property" and "assets" and every reference to their possessions means one of these things. It is unnecessary and confusing to employ "capital" in connection with them.¹⁸ The idea that it may mean such property as is necessary for the conduct of their business is in actual experience so vague as to be quite worthless. If legislatures wish to tax whatever property they possess, why not say so, instead of describing it as "capital" or "capital stock?"¹⁹ And if, nevertheless, they employ these terms inaccurately, while their intention appears from the context, why should not the courts simply declare the fact and say frankly that the wrong words were used, instead of stretching them to cover various unrelated conceptions and so perpetuate an extraordinary confusion?

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18. Unless, possibly, in the untechnical, but convenient phrase "working capital." In *Bent v. Hart* (10 Mo. Appeals 143), the court declared "capital stock" and "working capital" to be the same.

19. In *Pacific Hotel Co. v. Lieb* (83 Ill. 602), the court held that "capital stock" as employed in a tax law meant "all that belongs to the corporation as its property, whether tangible or intangible, and of whatever nature or kind" (page 610). So also *Reid v. Eatonton Mfg. Co.* (40 Ga. 98), at page 104, seemed to use it as "assets."